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UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC
CASE HISTORY
JULY 17, 2012

I. Introduction

Chairman Levin, Ranking Member Coburn, distinguished members of the Subcommittee, thank you for inviting me to testify today. I am pleased to have the opportunity to discuss the importance of the Department of the Treasury's efforts to identify and combat money laundering and terrorist financing vulnerabilities in the U.S. banking sector. I would also like to commend this Subcommittee for the leadership it has demonstrated historically and again today by focusing much-needed attention on these critically important issues.

At the outset, it is important to recognize that the United States maintains one of the strongest and most effective anti-money laundering and counter-terrorist financing (AML/CFT) regimes in the world. But the scale, efficiency and sophistication of the United States' financial system—particularly its banking sector—make it a prime target for those who seek to conceal and move illicit money. This involves not just money launderers, of course, but terrorists, proliferators, drug lords and organized crime figures, who must, at some point, rely on the financial system to move or launder the illicit funds supporting or derived from their operations.

Recent enforcement actions against financial institutions in the United States are a powerful reminder to us that challenges remain. To meet these challenges, we closely monitor evolving threats and work to adapt and strengthen our anti-money laundering and counter-terrorist financing and sanctions policies, regulations and authorities. This work is a key component of our government's national security efforts—it serves to protect the integrity of our financial system from abuse by terrorists, drug traffickers and other illicit actors and gives us tools to impede and halt their dangerous activities.

Several primary authorities and activities drive the Treasury Department's work to combat money laundering and terrorist financing. They include our role through the Financial Crimes

Enforcement Network (FinCEN) as administrator of the Bank Secrecy Act (BSA), which enables us to impose special regulatory measures and requirements to combat money laundering and terrorist financing on a broad array of financial institutions. They also include authorities delegated to us by Executive Orders issued pursuant to the International Emergency Economic Powers Act (IEEPA) to impose financial and economic sanctions, based on all-source intelligence, to disrupt and dismantle illicit financial networks, such as those that support weapons of mass destruction, proliferation, drug traffickers, transnational organized criminal groups and terrorists. Given the maturity, scope and depth of the anti-money laundering and counter-terrorist financing regime today, Treasury works closely with its interagency partners in the regulatory, law enforcement, and national security communities, as well as the private sector, to combat the various illicit financing threats we face. Furthermore, given the increasingly global nature of the financial system, our efforts to strengthen our own anti-money laundering and counter-terrorist financing regime rely on cooperation and collaboration with international counterparts.

II. Nature and Scope of the Threat

Financial crime and associated money laundering activity are difficult to measure with great precision. But by any estimate, the total amount of illicit money moved through and concealed within the U.S. financial system is massive—in the hundreds of billions—even if it represents only a small percentage of the funds in the financial system.

The sheer volume of money moving through the banking system makes banks the primary and most important line of defense against money laundering and terrorist financing. Therefore, our regulatory framework was built to require banks and other financial institutions to take a number of precautions against financial crime, including the establishment of AML programs and reporting and record keeping requirements to provide useful information to law enforcement and national security authorities for the purpose of combating the full range of illicit finance. This includes screening clients and transactions against Treasury's Specially Designated Nationals (SDN) List—a list of drug traffickers, proliferators, terrorists and other illicit actors or entities—to help ensure that funds associated with these actors do not enter the financial system. This regulatory framework aids banks in identifying and managing risk, provides valuable information to law enforcement, and creates the foundation of financial transparency required to apply targeted financial measures against the various national security threats that seek to operate within the financial system.

However when these safeguards are not stringently enforced, money launderers, terrorist financiers and other illicit actors are able to take advantage of the U.S. financial system. Some recent civil enforcement actions by FinCEN and the federal banking regulators illustrate how this can occur:

- In one case, failure to effectively monitor foreign correspondent banking relationships with high-risk customers and file suspicious activity reports (SARs) resulted in the processing of \$420 billion in cross-border financial transactions with thirteen high-risk

Mexican *casas de cambio* from 2004-2007, through wire transfers, bulk cash and pouch and remote deposits, including millions of dollars subsequently used to purchase airplanes for narcotics traffickers.

- In several cases, foreign banks “stripped” out the names of Iran or other sanctioned entities in transactions routed through the United States, resulting in billions of dollars of benefits to sanctioned parties. A Swiss bank developed elaborate procedures to alter payments and used code names to disguise identities of sanctioned entities. A Dutch bank used misleading payment messages, shell companies and even advised sanctioned clients on how to conceal their involvement in U.S. dollar transactions.
- One bank’s failure to have a written AML policy and inadequate procedures to ensure the timely reporting of suspicious activity resulted in the processing of billions of dollars through accounts controlled by thirteen Mexican *casas de cambio* in just one year without filing suspicious activity reports.
- Inadequate AML staffing and procedures at another bank resulted in deficient monitoring and subsequent processing of large volumes of traveler’s checks and third party checks indicative of money laundering, including through sequentially numbered instruments.

On account of these and other substantial vulnerabilities in anti-money laundering and counter-terrorist financing and sanctions compliance, the United States government has instituted criminal fines and forfeitures totaling more than \$4.6 billion in approximately 20 BSA and IEEPA criminal prosecutions of financial institutions over the past 6 years.

These civil and criminal enforcement actions reveal not only how illicit financiers abuse our banking system, but also how compliance with our anti-money laundering and counter-terrorist financing and sanctions requirements is critical to protecting our financial system from such abuse.

III. Improving Our AML/CFT Regime

These cases also point to significant vulnerabilities in the framework and enforcement of anti-money laundering and counter-terrorist financing requirements that require immediate attention. Treasury is working together with its interagency partners and the private sector to better understand the anti-money laundering and counter-terrorist financing and compliance challenges faced by financial institutions, clarify U.S. government expectations of financial institutions, and strengthen the overall anti-money laundering and counter-terrorist financing regulatory regime. I will briefly outline just a few of our efforts.

Ongoing Targeting of Illicit Actors

One of the most important activities for which my office is responsible is the listing of illicit actors on OFAC’s SDN list. As banks and financial institutions screen their business dealings

against the sanctioned entities on this list, they are able to prevent the entrance of terrorist funds, drug-trafficking proceeds or other illicit money into our formal financial system, or freeze transactions by designees where they occur. All major global banks, and many smaller foreign ones, screen transactions against the OFAC list to protect themselves, even though they are not required to do so. This markedly amplifies the impact of our sanctions by preventing the movement of illicit funds by terrorists, organized crime figures or proliferation networks outside of U.S. jurisdiction. We watch closely for illicit actors evading anti-money laundering and counter-terrorist financing controls at banks in the U.S. and abroad and for their attempts to seek “back door” entry into the financial system, including through the various evasive tactics evident in the cases described above.

Customer Due Diligence Advance Notice of Proposed Rulemaking

Customer due diligence, and the financial transparency it facilitates, is central to our efforts to combat all manner of illicit financial activity, from proliferation and terrorist financing to more traditional forms of financial crime like money laundering and securities fraud. Treasury issued an Advance Notice of Proposed Rulemaking (ANPRM) on March 4 to clarify, consolidate and strengthen customer due diligence requirements for financial institutions, including an obligation to collect beneficial ownership information. This rulemaking will improve financial institutions’ ability to detect suspicious activity and provide more useful information to law enforcement. The comment period for the ANPRM closed on June 11 and Treasury will hold the first in a series of public hearings to collect additional comments on July 31. Our engagement with industry in the customer due diligence rulemaking process is facilitating a broad understanding of higher risk type accounts and transactions with respect to money laundering and terrorist financing, and how we can work with industry and our interagency partners to better identify and manage such risks, including through more effective anti-money laundering and counter-terrorist financing safeguards.

Enhancing Transparency in the Company Formation Process

Criminals can easily disguise their ownership and control of illicit proceeds through shell companies and other seemingly impenetrable legal structures. We are working closely with you, Mr. Chairman, and other members of Congress to enact legislation requiring disclosure of beneficial ownership information in the company formation process.

Promoting and Strengthening the Global AML/CFT Framework

Helping to strengthen anti-money laundering and counter-terrorist financing regimes abroad has a direct benefit to the safety and integrity of the U.S. financial system, given the global nature of money laundering and the terrorist financing threat and the relationships between banks abroad. The Office of Terrorism and Financial Intelligence (TFI) works with others in the U.S. government to strengthen the global anti-money laundering and counter-terrorist financing framework as a foundation for the effective implementation of sound financial controls worldwide. Several intergovernmental and international organizations, such as the Financial Action Task Force, the IMF, the World Bank, the United Nations, and various FATF-style

regional bodies, collectively develop, assess and facilitate jurisdictional implementation of measures that are essential to combating various forms of illicit finance. Treasury and its interagency partners play a key leadership and participatory role in these organizations as well as other organizations that support our capacity building objectives, lending technical expertise in standard-setting, evaluation and policy recommendations related to the combating of money laundering, terrorist and proliferation financing. One of the key substantive accomplishments that we have achieved in developing the global anti-money laundering and counter-terrorist financing framework is to integrate targeted financial sanctions against terrorist financing and proliferation finance into the global standards for combating money laundering. This is some of the most innovative work my office conducts and an area in which we are able to urge the international community forward in highly constructive ways.

IV. Conclusion

I began today's testimony by noting that the U.S. is home to one of the strongest anti-money laundering and counter-terrorist financing systems in the world. In order to continue in this role, we must push ourselves to identify where we can do better, and work tirelessly to get there. I look forward to continuing work with this committee to this end.

Thank you.